

# Commentary

## Wheel In The Sky Keeps On Turning

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In an earlier era, insurance coverage debates concerned a small number of issues relating to environmental and mass tort claims: What does 'sudden and accidental' mean? What does 'damages' mean? Is the correct trigger exposure, manifestation, or the continuous trigger? Many practitioners believed that a finite amount of insurance coverage issues existed, and that courts would soon clear up any confusion.

The opposite occurred. Litigation became the norm between policyholders and insurance companies. Coverage issues have continued to multiply. Now, courts must determine the construction of each and every term in an insurance policy, and the number of decisions has mushroomed. The new case law can cause difficulty for insurance practitioners, because there is so much of it and it is so detail-oriented. Keeping up on insurance law in order to advise clients on emerging issues imposes an increasing burden on the practitioner.

As socio-economic change increases, insurance policies must be adapted to new scenarios unanticipated by the policy drafters. How does a D&O policy apply to Madoff's Ponzi scheme, or how does advertising injury coverage apply to battles between companies over claims whether food is natural? And the biggest questions are still on the horizon, such as insurance coverage and climate change.

The insurance world is adapting to these changes through two basic mechanisms. First, as new trouble spots arise, insurers race to exclude them from policies. The 'bump-up' exclusion in D&O policies is an example of this. On the other hand, insurers are devising new policies to meet their customers' needs in this area, as seen in such developments as green building insurance and A-Side D&O insurance.

This article brings together important insurance decisions from numerous jurisdictions on different issues. These decisions directly impact on the way in which insurance professionals apply their craft.

### **Environmental Insurance Law**

Several cases found that there were limits to the reach of the total or absolute pollution exclusion clause. In *Baughman v. United States Liability Ins. Co.*, 662 F. Supp. 2d 386 (D.N.J. 2009), the court addressed a situation in which a daycare center operated in a former thermometer factory, exposing the children to mercury fumes. The court found that such indoor exposure was not traditional environmental pollution pursuant to New Jersey law, and that the policy's pollution exclusion clause therefore did not apply.

In *Barrett v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 2010 Ga. App. LEXIS 448 (Ga. Ct. App. May 11, 2010), a worker was exposed to natural gas while working on an installation project. The court found that natural gas was not a pollutant pursuant to the insurance policy, and that it would be illegal under Georgia law to sell an insurance policy to a company "whose main product is natural gas, which policy contains an exclusion for damages resulting from such natural gas."

Similarly, *Bosserman Aviation Equipment v. United States Liability Insurance Co.*, 183 Ohio App. 3d 29 (3rd Dist. 2009) addressed a workplace exposure to chemicals. The court held that the exclusion was meant to address traditional environmental pollution, and not workplace exposure.

On the other hand, *Devcon Int'l Corp. v. Reliance Ins. Co.*, Nos. 07-4602/08-1996, 2010 U.S. App. LEXIS 11619 (3rd Cir. June 8, 2010) (applying Virgin Islands' law) concerned a construction project that raised large amounts of dust that contaminated drinking water and caused breathing disorders. The court held that the pollution exclusion did bar coverage for this loss.

Two camps exist with respect to the interpretation of the absolute pollution exclusion. Some jurisdictions read the exclusion very broadly, and exclude claims involving a wide variety of substances that in common parlance are not considered pollutants. Others, such as the jurisdictions discussed above, use a multi-factored approach to determine if the loss in issue resembled what is thought of as traditional environmental pollution.

*Proformance Insurance Co. v. Riggins*, No. A-2846-08T1, 2010 N.J. Super. Unpub. LEXIS 918 (N.J. App. Div. April 27, 2010) is also of interest. In that case, remediation of groundwater compelled the demolition and rebuilding of a house. The liability insurer did not contest its liability for the demolition, but asserted that the rebuilding was the responsibility of the property insurer. The court disagreed, finding that both the demolition and rebuilding resulted from the third party groundwater contamination, so that the general liability policy applied.

### Professional Services Exclusions

In *Wimberly Allison Tong & Goo v. Travelers Property Cas. Co.*, 2009 U.S. App. LEXIS 25294 (Ct. App. 2009), the insured was the architect of a parking garage

that collapsed. The insured argued that while its professional liability policy covered some of the allegations of the complaint against it, other allegations asserted non-professional negligence, and should be covered under its general liability policy. The court found that all of the allegations stemmed from the insured's provision of professional services, and denied coverage for the entire complaint on the basis of the professional liability exclusion in the general liability policy.

In *Western Nat. Mut. Ins. Co. v. Structural Restoration Inc.*, 2010 Minn. App. Unpub. LEXIS 406 (Minn. Ct. App. May 4, 2010), the court also denied coverage on the basis of the general liability policy's professional services exclusion. The insured inspected the structural integrity of several silos and found them suitable for grain storage. A few years later, one collapsed and the silo owner's insurer sued the insured for damages in the underlying action. In the coverage action, the insured argued that its actions did not amount to a professional service where its employee was "asked to 'stop by' to see if he would recommend 'any preventative maintenance or crack repair.'" Nevertheless, the court found that the inspection and opinion rendered by the insured was not one a lay person could make. Instead, the insured used its specialized knowledge and experience in concrete restoration, triggering the professional services exclusion in the policy.

Professional services exclusions are appearing in a wide assortment of policies, including D&O. Policyholders must look carefully at all of their operations to determine if they need professional liability coverage, and must keep in mind that different states apply different standards to what constitutes 'professional services.'

### Directors And Officers Insurance

*Pendergest-Holt, et al. vs. Certain Underwriters at Lloyd's of London and Arch Specialty Insurance Co.*, 600 F.3d 562 (5th Cir. 2010), is a major victory for policyholders. The 'conduct' exclusions in a D&O policy often obligate the insurer to pay for the insured's defense until there is a finding 'in fact' of wrongdoing. In *Pendergest-Holt*, the insurer argues that sufficient facts had been adduced in the underlying trial to establish wrongdoing in fact to the insurer's satisfaction. Specifically, one insured defendant had pled guilty, and named the other individual defendants as implicated in those wrongful acts. The court disagreed. It found that 'in fact' meant that a finding by a court of actual

wrongdoing by the insured was necessary before an insurer could stop paying defense costs; the insurer could not decide on its own when it had acquired sufficient facts.

In *In Re Downey Financial Corp.*, 2010 Bankr. LEXIS 1347 (Bankr. Del. May 7, 2010), the court addressed the competing rights of the individual insured versus the insured company to D&O insurance proceeds, finding on the facts of the case before it, the individuals had the right to access the policies. However, the case demonstrates that the decision on priority is very fact sensitive. In Downey, for example, the court found that the entity could no longer bring a securities claim under the policy and that the past costs that the entity had paid were within the retention. As a result, the balance of the policy proceeds was available to the individuals. This decision underscores the need for 'Side A' coverage, coverage that is only available to the individuals and not to the entity.

*Somerset Medical Center v. Executive Risk Indemnity Company*, A-6214-08T2, 2010 N.J. Super. Unpub. LEXIS 605 (N.J. App. Div. March 22, 2010), arises out of the nurse, Tim Cullen, who murdered twenty-nine patients. A complaint against Somerset and its directors alleged negligent hiring, negligent supervision and entrustment, negligent reporting, and negligent continuation of employment. Executive Risk's D&O policy excluded claims 'based on, arising out of, directly or indirectly resulting from, in consequence of or in any way involving' bodily injury, and Executive Risk therefore disclaimed coverage. The Appellate Division disagreed. It held that the underlying complaint was premised on the hospital's professional negligence and that the negligence, not the bodily injury, was the proximate cause of the complaint.

*Abercrombie & Fitch v. Federal Insurance Co.*, 2010 U.S. App. LEXIS 5282 (6th Cir. March 11, 2010) concerned the insured's duty to cooperate under a D&O policy. Abercrombie's D&O policy expired on September 1, 2005, and gave Abercrombie the right to purchase a one-year Extended Reporting Period. Abercrombie had already arranged to purchase a new policy effective September 1, 2005 from National Union Fire Insurance Company. On September 2, 2005, Abercrombie was sued. It therefore purchased the Extended Reporting Period from Federal, and renegotiated its D&O policy with National Union to be excess to the Federal policy. Federal protested that Abercrombie's

arrangement violated Abercrombie's duty to cooperate with it. Over a vigorous dissent, the Sixth Circuit held that the 'duty to cooperate' provision only applied to cooperation in the handling and settlement of claims, and not to all aspects of the formation of the insurance policy.

*MBIA, Inc. v. Federal Insurance Company, et al.*, 2009 U.S. Dist. LEXIS 124335 (S.D.N.Y. Dec. 30, 2009) concerned the definition of 'claim.' In that case, the insurer argued that subpoenas issued by the New York Attorney did not constitute an investigative order sufficient to trigger coverage under the Securities Claim definition in its insurance policy. The Court disagreed, noting that even if the subpoena was not an "order", the policy's definition of a Securities Claim - which included "a formal or informal administrative or regulatory proceeding or inquiry commenced by the filing of a notice of charges, formal or informal investigative order or similar document" - was broad enough to encompass the NYAG subpoena. The insurer similarly argued that the costs incurred in responding to additional, oral requests for documents without the NYAG issuing a formal subpoena would not be covered as the insured was not responding to a "claim" pursuant to the Policy language. The Court sided with the insured regarding these responses as well, concluding that the insured was responding to discovery requests in the context of the NYAG's investigation, and was therefore responding to a regulatory demand constituting a Securities Claim.

New exclusions continue to bar coverage for policyholders. In *In Re Delta Financial Corp.*, 604 F.3d 408 (3d Cir. Del. 2010), the insured sought coverage for claims from noteholders arising out of its bankruptcy restructuring. The noteholders asserted that they did not receive adequate compensation. However, the policy had an exclusion for "allegedly inadequate. . .consideration in connection with the company's purchase of securities issued by any company. . . .", which the court held foreclosed coverage. In *Associated Community Bancorp. v. The Travelers Companies, Inc.*, 2010 WL 1416842 (D. Conn. April 8, 2010), the insured sought coverage for its loss in the Madoff Ponzi scheme. The court held that an insolvency exclusion barred coverage, since Madoff was insolvent.

Insurance professionals need to be vigilant on D&O coverage. Case law develops rapidly, often with splits

between jurisdictions. At the same time, insurance companies continue to tinker with the policies, so that policyholders must parse every line of the policy, since a seemingly minor change in wording can have vast consequences.

### Property Damage Issues

The issue of the 'number of occurrences' continues to result in the loss of insurance coverage for insureds. In *Bausch & Lomb, Inc. v. Lexington Ins. Co.*, 679 F. Supp. 2d 345 (W.D.N.Y. 2009), Bausch & Lomb sought coverage for thousands of personal injury claims resulting from its sale of contact lens solution. Bausch & Lomb's policy had a \$2,000,000 uncapped per occurrence deductible without an aggregate. The court agreed with the insurer that each separate claim was a separate occurrence, and that Bausch & Lomb only had coverage for individual claims that exceeded \$2,000,000.

However, the Supreme Court of Delaware reached the opposite result in *Stonewall Ins. Co. v. E.I. DuPont du Nemours*, No. 523,2009 (June 3, 2010). That case concerned thousands of individual claims arising from leaking polybutylene plumbing systems. DuPont sold the resin used in the systems. The court found that the faulty manufacture and distribution of the resin constituted a single occurrence.

On the one hand, courts are simply divided on a key coverage issue. At the same time, attorneys are trying to distinguish cases based on the precise policy wording and circumstances. Policyholders must make sure that the broker uses language that limits the risk on this issue.

In *Silgan Containers Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 2010 U.S. Dist. LEXIS 30100 (N.D. Cal. March 29, 2010), the insured sold cans to Del Monte to contain food products. The pull tabs on the cans malfunctioned so that consumers could not open the cans. The court denied coverage, holding that while the cans were defective, they did not result in any physical damage to the food product. Arguably, the court could have found that the loss of the use of the food product constituted property damage.

*Specialty Surfaces Int'l, Inc. v. Continental Casualty Co.*, 2010 U.S. App. LEXIS 11620 (3rd Cir. June 8, 2010) also concerned property damage. The complaint against the insured originally only alleged that the insured's product, synthetic turf, was defective; the court

found that the complaint did not allege property damage. The amended complaint then alleged damage to the synthetic turf, the liner, the subdrain system, and the subgrade, which was prepared by a third party. The insured argued that the damage to the subgrade was third party damage. The court disagreed, holding that the damage to the subgrade was a foreseeable result of the defective turf, and not an accident. Courts in New Jersey and elsewhere may disagree with this result.

Here too, attorneys need to be creative in crafting their arguments, and brokers must understand their clients' products and make sure that claims arising from them will be covered.

### Broker Liability Issues

In *State of Connecticut v. Acordia, Inc.*, 2010 Conn. Super. LEXIS 800 (Conn. Super. Ct. April 19, 2010), the Superior Court of Connecticut held that Acordia, Inc., an independent insurance agent/broker, violated the Connecticut Unfair Trade Practices Act by failing to disclose to its customers a contingent fee arrangement with certain insurers that resulted in a greater commission for selling the products of the participating insurers. Notably, the court reached its decision even though the court found that the brokers acted in the customers' best interest and in many cases, did not have knowledge of the contingent fee arrangement at issue. The court reasoned that the brokers, as fiduciaries, had an obligation to disclose all conflicts of interest to their principals and that failure to do so violated Connecticut public policy in effect during the relevant time period (1999-2002). Notwithstanding the above ruling, however, the court declined to issue an injunction because when the decision was rendered, the public policy of Connecticut had changed – in 2010, the legislature enacted a statute “which requires only that a broker paid both by the insured and an insurer disclose the amount of compensation he will derive from the insurer.”

### Personal And Advertising Injury

In *Giovanni Cosmetics, Inc. v. Arch Ins. Co. et al.*, CV 09-5548 GAF (C.D. Cal. Feb. 5, 2010), the District Court for the Central District of California held that an insurer did not have a duty to defend and indemnify its insured, a company that markets personal care products such as soap, against claims from a competitor that the insured improperly labeled and advertised its products as

“organic”. The court reasoned that the damage alleged by the insured’s competitor was not an “advertising injury” cognizable under the underlying insurance policies. The term “advertising injury” was defined as, inter alia, “the use of another’s advertising idea in your ‘advertisement.’” According to the court, the use of the term “organic” was not the use of another entity’s advertising idea but instead, was merely the misuse of a labeling term defined by a neutral third party and to be utilized by all in the market place.

In *Harleysville Mut. Ins. Co. v. Buzz Off Insect Shield, L.L.C.*, 364 N.C. 1 (2010), the Supreme Court of North Carolina held that an insurer was not obligated to defend its insured, an entity that adds insect repellent to clothing manufactured and marketed by others,

against claims made by competitors for injury resulting from allegedly false advertisements made by the insured regarding the clothing bearing its insect repellent. The Court reasoned that coverage was excluded pursuant to the Failure to Conform exclusion found in the underlying insurance policy, which the Court deemed to exclude coverage for false statements in advertisements made by the insured regarding its own products.

It will be interesting to see if the insurance industry develops new policy provisions to offer protection on this emerging issue.

### **Conclusion**

The conclusion is the easy part. Keep daily watch on case developments, and read insurance policies carefully. ■